Preparing for the Sea Change in the Merger & Acquisition Scene

Introduction

Not all mergers will give rise to competition issue. Some mergers can be pro-competitive as they can enhance the level of rivalry between the market players. For example, a merger may prevent a failing enterprise from exiting the market thus maintaining competition between the market players and will eventually help to eliminate or minimise monopolisation by the dominant players. As a result, market players and consumers can reap the benefits from the pro-competitive mergers.

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How is merger defined under the proposed new provisions of Competition Act 2010?

Just like how an "agreement" has different interpretations under competition law from the common understanding of what constitutes a contract, the same goes to the definition of "merger". The word "merger" has different meaning under the proposed new Section 10B of the Competition Act 2010 ("**CA 2010**") from the common understanding of what constitute a "merger".

Under the proposed new section 10B of CA 2010, there are four circumstances under which a merger may occur[1]:

(a) two or more previously independent enterprises combine into one single enterprise and cease to exist as separate legal entities;

(b) the acquisition of direct or indirect control of the whole or part of one or more enterprises;

(c) the acquisition of assets of one enterprise by another enterprise results in the acquiring enterprise replacing or substantially replacing the enterprise whose assets are being acquired, in the business or the part concerned of the business, in which the acquired enterprise was engaged immediately before the acquisition; or

(d) the creation of a joint venture to perform, on a lasting basis, all the functions of an autonomous economic entity.

What amounts to control under the proposed merger control regime?

Under the concept of direct or indirect control, the determination of whether a merger exists under the proposed new Section 10B seems to be based on a qualitative rather than quantitative criteria.[2] An enterprise is said to be in control of another enterprise when the enterprise can exercise decisive influence on the other enterprise by reason of rights, contracts or any other means either separately or jointly.[3]

Control can therefore exist when minority shareholders are conferred decisive influence on the activities of an enterprise.[4] For example, minority shareholders may have the rights to vote and to influence the decision of an enterprise via the rights listed in the reserved matters provided in a shareholders' agreement. Minority shareholders may have control over the enterprise when they are allowed to influence essential decisions such as the business plans, budgets, major investments and appointment of the top management of the enterprise.

What type of business transaction that will not be considered as a merger?

Commercial or economic activities that may not amount to a merger under the circumstances as provided in the proposed new Section 10C of CA 2010[5] are:

(a) the control is acquired by a person acting in his capacity as receiver or liquidator or an underwriter;

(b) all of the enterprises involved in the merger are, directly or indirectly, under the control of the same enterprise;

(c) the control is acquired solely as a result of a testamentary disposition, intestacy or the right of survivorship under a joint tenancy; or

(d) the control is acquired by an enterprise whose normal activities include the carrying out of transactions and dealings in securities for its own account or for the account of others in the circumstances specified below:

(i) the securities acquired are on a temporary basis (calculated 12 months from the date on which control of the other enterprise); and

(ii) the acquiring enterprise must not exercise the voting rights with a view to determining the strategic commercial behaviour of the target enterprise or must exercise these rights only to prepare the total or partial disposal of the enterprise, its assets or securities.

Substantial Lessening of Competition vs Economic Efficiencies

Once it is established that a transaction will be considered as a merger under the proposed new provisions of CA 2010, the next step is to evaluate whether the merger would result in an SLC. In carrying out the SLC test, below are the factors that will be typically considered in establishing the existence of the SLC[6]:

(a) market power and market concentration;

(b) competitive effects arising from the merger;

(c) entry and expansion; and/or

(d) countervailing buyer power.

The proposed merger control regime provides an avenue for enterprises to relieve their liability from the prohibition of merger if the economic efficiencies outweigh the adverse effect from the substantial lessening of competition ("**SLC**") arising from the said merger.[7] The burden of proof is on the enterprises to prove the economic efficiencies. Economic efficiencies may occur through a merger between two enterprises in a market. For instance, the merger may lead to cost saving (fixed or variable), more intensive use of existing capacity, economies of scale, increase of network size and improvement of product quality.[8]

In addition, merger may also incentivise the newly merged entity to coordinate in sharing resources and invest more on research and development. This would eventually foster innovation and further stimulate competition between the existing market players.[9]

Looking Ahead and Managing the Process

Businesses may want to start thinking strategically in facing the coming sea change brought by the proposed merger control regime. Below are amongst the matters that businesses should factor in when considering a merger transaction.

(a) Is it mandatory to notify?

Since the proposed merger control will adopt a hybrid notification regime, mandatory pre-notification is only for the anticipated merger that exceeds the threshold prescribed in the Gazette after the amendments to CA 2010 have been passed.[10] Businesses may notify the competition authority voluntarily if the threshold is not met.

(b) How and when to notify?

Internally, the enterprise needs to ensure that the necessary documents are in place before submitting the documents and forms requested by the competition authority. Incomplete documentation may lead to delays in the approval process.

Businesses will need to identify the right strategy and timing before approaching and liaising with the competition authority. Just like an effective storytelling, the narrative must be well developed.

For instance, an enterprise needs to ascertain its position as well as its parent company's position in the market. Understanding the position is essential in establishing the extent of dominance that it may exert in a particular market. It is important for the enterprise to identify any competition concerns that may arise from the anticipated merger before starting the dialogue process with the competition authority. Businesses should also deliberate on the potential justifications that they may put forward against the arising competition concerns. The market players are usually the experts of their particular market.

Therefore, dialogues between the competition authority and the merger parties are necessary to enable the authority to understand the market well before arriving at an informed decision. An effective dialogue between the enterprise and the competition authority should only be done once the internal process is sorted out.

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1 Salient Points of the Proposed Amendments to the Competition Act 2010 (Act 712) released by MyCC, at page 10.
2 CCCS Guidelines on the Substantive Assessment of Mergers, page 5 at paragraph 3.3.
3 Proposed New Section 10B of Competition Act 2010 (Act 712).
4 CCCS Guidelines on the Substantive Assessment of Mergers, page 5 at paragraph 3.3.
5 Salient Points of the Proposed Amendments to the Competition Act 2010 (Act 712) released by MyCC, at page 12.
6 Malaysian Aviation Commission's Guidelines on Substantive Assessment of Mergers, at page 10.
7 Proposed New Section 10D of Competition Act 2010 (Act 712).
8 CCCS Guidelines on the Substantive Assessment of Mergers, page 24 and 25 at paragraph 7.20 - 7.22.
9 CCCS Guidelines on the Substantive Assessment of Mergers, page 24 at paragraph 7.20.
10 Consultation Paper on the Proposed Amendments to the Competition Act 2010, at page 21.

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